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IN THE

Supreme Court of the United States

October Term, 194 . No. 923.

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION,

Petitioner,

v.

~~GUY T. HELVERING~~, Commissioner of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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TABLE OF CONTENTS OF PETITION.

	Page
Question Presented	1
Statutes and Regulations Involved	2
Summary Statement of the Matter Involved	2
Errors Assigned	6
Reasons for Granting the Writ	7

CASES CITED IN PETITION.

	Page
Alpha Claude Neon Corporation v. Pennsylvania Distilling Company, 325 Pa. 140; 188 Atl. 825	7
American Crystal Sugar Co. v. Nicholas, 124 Fed. 2d 477	8
Borin Corporation v. Commissioner, 117 F. 2d 917, cert. den. 314 U. S. 638	8
Brooklyn Life Insurance Co. v. Dutcher, 95 U. S. 269, 273	7
Commissioner v. H. F. Neighbors Realty Co., 81 Fed. 2d 173	8
Helvering v. Ohio Leather Co. et al., 317 U. S. 102	7, 8
Indianapolis Glove Co. v. U. S., 96 Fed. 2d 816	8
Pugh et al. v. Commissioner, 49 Fed. 2d 76, cert. den. 284 U. S. 642	8

STATUTE CITED IN PETITION.

	Page
Revenue Act of 1936, Section 26 (c) (1)	2, 6

TABLE OF CONTENTS OF BRIEF.

	Page
Opinion Below	11
Jurisdiction	11
Statement	11
Argument	12
Conclusion	18

CASES CITED IN BRIEF.

	Page
Alpha Claude Neon Corporation v. Pennsylvania Distilling Co., 325 Pa. 140, 188 Atl. 825	14
American Crystal Sugar Co. v. Nicholas, 124 Fed. 2d 477	17
B. F. Goodrich Co. v. Wilson, 337 Pa. 333, 10 A. 2d 422	15
Borin Corporation v. Commissioner, 117 Fed. 2d 917, cert. den. 314 U. S. 638	17
Brooklyn Life Insurance Co. v. Dutcher, 95 U. S. 269	14
Carthage T. P. Mills v. Village of Carthage, 200 N. Y. 1	15
Chess & Wymond, Inc. v. Glenn, 40 F. Supp. 666, aff. 132 Fed. (2d) 621	12
Commissioner v. H. F. Neighbors Realty Co., 81 Fed. 2d 173	17
Hagarty v. Wm. Akers, Jr. Co., 342 Pa. 236, 20 A. 2d 317	15
Indianapolis Glove Co. v. U. S., 96 Fed. 2d 816	17
Loeb v. Ferber, 346 Pa. 348, 30 A. 2d 126	15
Pugh et al. v. Commissioner, 49 Fed. 2d 76, cert. den. 284 U. S. 642	17

STATUTES CITED IN BRIEF.

	Page
Judicial Code, as Amended by the Act of February 13, 1925, Section 240 (a), c. 229, 43 Stat. 1938	11
Revenue Act of 1936, Section 26 (c) (1)	13

TABLE OF CONTENTS OF APPENDIX.

	Page
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 26 (c) (1)	19
Treasury Regulations 94, Promulgated Under the Revenue Act of 1936, Art. 26-2	19

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No.

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~~GUY T. HELVERING~~, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Welsbach Engineering and Management Corporation, formerly Welsbach Street Illuminating Company, respectfully prays for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit to review an order of that Court entered on January 28, 1944, affirming the decision of the Tax Court of the United States.

QUESTION PRESENTED.

The question presented is:

Whether the petitioner, in determining its undistributed net income for 1936 and 1937 for the purpose of computing the surtax on undistributed profits, was entitled to a credit against adjusted net income as provided in Section

26 (c) (1) of the Revenue Act of 1936 because no distributions could be made within the taxable years as dividends without violating a provision of a written contract, expressly dealing with the payment of dividends, executed by the petitioner prior to May 1, 1936.

STATUTES AND REGULATIONS INVOLVED.

The pertinent portions of the applicable statutes and regulations are set forth in the Appendix (infra, pp. 19, 20).

SUMMARY STATEMENT OF THE MATTER INVOLVED.

On or about December 31, 1928, petitioner had outstanding $1,700,000 principal amount Collateral Trust Bonds due January 1, 1938, secured by a Collateral Trust Indenture, dated January 1, 1923, which bonds were owned by The United Gas Improvement Company (herein sometimes called United). United was then the owner of 99.4% of the stock of American Gas Company of New Jersey (herein sometimes called American), which at that time had been reduced in function to the holding of investment securities. American had no office and no organization of its own except as it was officered by the officers of United and it was contemplated that American would be dissolved as soon as certain legal questions were solved. On December 31, 1928, and as a convenience, United transferred all the bonds to American (9a, 10a, 16a-18a, 60a-62a).*

Early in 1933 petitioner was in financial difficulties and requested United to defer the current sinking fund payments on its bonds and to consent to the subordination of the lien of the Bond Indenture on certain accounts receivable to the pledge of such accounts for bank loans, including a loan from Chase National Bank (23a, 24a, 61a, 64a, 65a). United assented and agreements were entered into between petitioner and American in which petitioner covenanted not

*Numbers refer to page numbers of Petitioner's Appendix unless otherwise stated.

to pay any dividends until the sinking fund payments were fully current (24a-28a, 61a, 64a, 65a).

Later in 1933 petitioner sought from United (which then owned 99.99% of American's stock) a permanent modification of the Bond Indenture, to which United agreed upon certain conditions, including provision that no dividends should be paid without its consent (10a, 11a, 12a, 61a, 62a, 65a). As a result the following agreements and letters were executed and delivered:

1. Supplemental Indenture, dated December 29, 1933, and letter from American to Indenture Trustee, dated January 5, 1934, consenting thereto (13a, 19a, 30a, 37a, 38a).

2. Letter from petitioner to American, dated January 5, 1934, in which petitioner agreed not to pay dividends nor to increase the salaries of its executive officers without consent and to determine by mutual agreement the proper amount of depreciation for purposes of the amended sinking fund provisions. The letter reads as follows (33a, 34a):

> "261 North Broad Street,
> Philadelphia, Penna.,
> January 5, 1934.
>
> The American Gas Company,
> 1401 Arch Street,
> Philadelphia, Pa.
>
> Gentlemen:
>
> In consideration of the consent of your Company, as the holder of all of this Company's outstanding Collateral Trust Six Per Cent. Fifteen Year Sinking Fund Gold Bonds, to the execution and delivery of the Indenture dated as of December 29, 1933, supplemental to the Indenture dated as of January 1, 1923, from our Company to Fidelity Trust Company securing said bonds, we agree that so long as your Company shall hold any of said bonds that our Company will not, with-

out the prior written consent of your Company, pay any dividends on its capital stock or increase the salaries of its executive officers, either as officers of our Company or of its Subsidiary Companies, above the respective amounts of such salaries on January 1, 1934, as set forth in a list which we have delivered to Mr. W. W. Bodine, Vice-President of your Company, and that the proper amount of depreciation and obsolescence charges to be set aside by our Company and its Subsidiary Companies under the provisions of Section 2 of Article Two of said Indenture dated as of January 1, 1923, as amended, by said Supplemental Indenture, shall be determined annually by agreement with your Company.

Yours very truly,

WELSBACH STREET ILLUMINATING COMPANY

By Eugene S. Newbold
President"

Article II, Section 2, of the Bond Indenture, as amended, prescribed certain sinking fund payments based on the earnings of the petitioner and its subsidiaries for the preceding calendar year after certain deductions for depreciation and obsolescence and provided that the balance of such earnings after making the annual sinking fund payment " . . . *shall be retained by the Corporation or Subsidiary Companies for depreciation or other requirements of their business*".* Article II, Section 3, provided that the petitioner should furnish the Indenture Trustee with annual earnings statements on which the sinking fund payments were based (30a-32a).

In December, 1936, United (which then owned 100% of American's stock) caused American to be dissolved, and

*Italics supplied.

on December 24, 1936, American's assets including the $926,000 principal amount of petitioner's bonds then outstanding were distributed to United as the sole stockholder thereof (10a, 13a, 14a).

Petitioner's letter of January 5, 1934, was drafted by the legal staff of United to carry out the arrangement which the officers of petitioner negotiated with the officers of United and American. The primary interest of United was to make certain that there would be no dilution of petitioner's assets or its earnings through the payment of dividends and the provisions of Article II, Sections 2 and 3, of the Bond Indenture were buttressed by petitioner's letter. Bodine, Vice President of United and American, would not have consented to the modification if the petitioner insisted on limiting the dividend restriction to the actual period of ownership of the bonds by American. Petitioner looked upon United as the real party in interest and regarded the letter of January 5, 1934, as altogether applicable to United. The officers of United always considered the letter as extending to United. They knew of no one having questioned United's right to the benefit of the agreement nor did they know why anybody would raise any question (61a-63a, 65a, 67a, 68a).

Petitioner never tried to disregard the terms of the agreement. On the contrary in 1936 and 1937 Newbold as President of petitioner informally applied to Bodine, Vice-President of United, for permission to pay dividends but Bodine discouraged him and no formal request was ever made. Previously petitioner had had no net earnings for some years and in 1938 petitioner suffered a net loss (33a, 63a, 64a, 67a).

In accordance with the letter of January 5, 1934, petitioner, early in 1937, obtained United's approval to certain increases in executive salaries. In every year both before and after 1936, as provided in the letter, petitioner submitted to United statements of petitioner's auditors computing depreciation charges (33a-35a, 63a, 66a, 67a).

Petitioner did not declare or pay dividends during 1936 and 1937 (18a).

The petitioner claimed a credit, as provided in Section 26 (c) (1) of the Revenue Act of 1936, equal to its entire adjusted net income for 1936 and 1937 upon the grounds that no amounts could be distributed within the taxable years as dividends without violating a provision of a written contract, expressly dealing with the payment of dividends, executed by it prior to May 1, 1936, and set forth the letter agreement of January 5, 1934 (33a), as such a contract, whether considered separately or as a part of the group of contracts comprising also the supplemental indenture dated December 29, 1933 (30a) and the letter from American to the Trustee dated January 5, 1934 (37a).

The Respondent determined that the petitioner was not entitled under Section 26 (c) (1) of the Revenue Act of 1936 to any credit for either of said years by reason of contractual provisions prohibiting dividend payments (19a). The Commissioner was sustained by the Tax Court of the United States in a Memorandum Findings of Fact and Opinion of December 26, 1942 (69a-75a) and determined the deficiencies to be $33,788.21 for 1936 and $21,520.19 for 1937 (76a).

Petitioner duly petitioned the United States Circuit Court of Appeals for the Third Circuit to review the decision of the Tax Court and on January 28, 1944, the Circuit Court of Appeals affirmed the decision of the Tax Court. The opinion of the Honorable Albert Branson Maris, Circuit Judge, is printed in the record submitted herewith. (R. 77)

ERRORS ASSIGNED.

The Circuit Court of Appeals erred in holding that petitioner's letter of January 5, 1934, did not constitute a contractual prohibition against payment of dividends during the years 1936 and 1937 and in affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

1. The record shows by abundant clear, undisputed and wholly credible evidence that, at the time the letter agreement of January 5, 1934, was made, United, as the owner of 99.99% of the stock of American, was the real party in interest; American was but a temporary resting place for the bonds pending its dissolution then in contemplation; the dividend prohibition was intended to be for the benefit of the United enterprise, of which American was a part and petitioner, American and United, by their actions, mutually construed the agreement as having that effect; and such meaning was implicit in the objective of the agreement and all the attendant circumstances at the time the agreement was made. It having thus been established that the parties intended and construed the agreement to mean that the dividend prohibition should be in effect so long as American, or United as the real party in interest and American's prospective successor, should hold any of the bonds, the Court should have given the agreement the exact effect which the parties themselves gave to it. *Alpha Claude Neon Corporation v. Pennsylvania Distilling Company,* 325 Pa. 140; 188 Atl. 825; *Brooklyn Life Insurance Co. v. Dutcher,* 95 U. S. 269, 273. Nevertheless, both the Tax Court and the Circuit Court of Appeals held, as a matter of law, that the agreement was not ambiguous on its face and that, therefore, the dividend prohibition terminated with the transfer of the bonds to United, no matter what the intent of the parties may have been, as shown by their construction of the agreement and the surrounding circumstances. In so doing, both Courts have, at the instance of one who is collaterally attacking the agreement, applied a stricter standard than would be applied by the Pennsylvania courts between the parties under the principles governing the construction of contracts.

2. The case of *Helvering v. Ohio Leather Co. et al,* 317 U. S. 102, relied on by the Tax Court, is distinguishable.

In that case there was no history of a construction by the parties, nor any evidence of intention that the sinking fund payments should irrevocably be set aside in the calendar year in which they were earned. Having misconceived the purport of the *Ohio Leather Company* case, the Tax Court erroneously applied it to this case and failed to give consideration to the intent and meaning of the agreement apparent from the surrounding circumstances and construction of the parties. This error was not corrected and was in effect repeated by the Circuit Court of Appeals.

3. The Court below, at the instance of a stranger to the agreement, have misconstrued the law in refusing to recognize for tax purposes an agreement as to whose intent and effect the parties in interest were in entire accord and the terms of which complied with the requirements of the tax statute.

4. The Circuit Court of Appeals for the Third Circuit has adopted a position inconsistent with that of other Circuits in refusing to give any weight to the uncontradicted, credible testimony of both parties to the contract as to its meaning. It has applied the parol evidence rule despite the fact that the controversy was not between the parties to the contract. The Fifth Circuit apparently follows the same rule. *Pugh et al. v. Commissioner,* 49 Fed. 2d 76; (CCA 5, 1931) certiorari denied; 284 U. S. 642. Other Circuits and Courts, however, have adopted the contrary view. *Borin Corporation v. Commissioner,* 117 Fed. 2d 917 (CCA 6, 1941), certiorari denied, 314 U. S. 638; *American Crystal Sugar Co. v. Nicholas,* 124 Fed. 2d 477 (CCA 10, 1941); *Commissioner v. H. F. Neighbors Realty Co.,* 81 Fed. 2d 173, (CCA, 6, 1936); *Indianapolis Glove Co. v. U. S.,* 96 Fed. 2d 816, (CCA 7, 1938). This question of general law should be finally resolved.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the

Circuit Court of Appeals for the Third Circuit should be granted.

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April 20, 1944.

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 194 .

No. .

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION,

Petitioner,

v.

~~GUY T. HELVERING,~~ COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINION BELOW.

The opinion in the United States Circuit Court of Appeals for the Third Circuit is reported in 140 Fed. (2d) 584 and is printed in the record submitted herewith. (R. 77)

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered January 28, 1944. This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 1938.

STATEMENT.

A statement of the facts, questions presented, statutes and regulations involved, and errors relied upon, will be found in the foregoing petition.

ARGUMENT.

This case turns on the question whether the phrase "so long as your Company shall hold any of said bonds" is to be given literal and narrow effect, or the meaning and effect given by those primarily concerned and implicit in their relationship and their objective.

The Tax Court and the Circuit Court of Appeals have reasoned that, since the agreement was made with American and is not ambiguous on its face, "your Company" can only mean American, and, therefore, the taxes must be paid. Stated another way, they say the phrase cannot be construed to mean "so long as your Company or its successor shall hold any of the bonds", nor can it be given comparable effect with respect to United, no matter what the other facts may be. Thus they ignore the uncontradicted testimony of Messrs. Bodine, Newbold, DellPlain, Scott and Cole, the construction of the agreement by the petitioner on the one hand and American and United as its successor on the other hand in all their actions from the inception of the agreement, and the logic and common sense of the situation (61a-68a). Thus they say in effect that these men, who made and lived with the arrangement and always regarded it as protective of United, were mistaken or misguided in not taking a contrary view in December, 1936, when American was dissolved and the bonds transferred to United.

Looking at the situation of those primarily concerned, one may not reasonably suppose that the officers of American and United, knowing that American was to be dissolved, intended to protect American and not United, or that the officers of petitioner intended to short change United as the real party in interest. The officers of petitioner never questioned United's right to such protection nor could they have done so in good conscience.

In *Chess & Wymond, Inc. v. Glenn,* 40 F. Supp. 666, aff. 132 Fed. (2d) 621, the Court in finding that there was a

written contract prohibiting the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936, stated at page 670:

> ". . . If the statute had been in existence at the time of the negotiations between the plaintiff and the bank, it would have been comparatively easy to have executed a written contract complying in every respect with the provisions of the statute and no doubt attention would have been given to precisely meeting those requirements. In such a case the formal contract should be strictly and literally construed. But the Court should consider the question from a much more liberal viewpoint when it analyzes a written agreement, informally entered into without intending to comply with any statutory requirements, because none existed, and without any thought or suggestion that it would be later tested for exact compliance with the provisions of a statute subsequently enacted and that it would be declared invalid if it did not meet that pattern in every detail. As was pointed out by Chief Justice Hughes in National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U. S. 1, at page 41, 57 S. Ct. 615, 81 L. Ed. 893, 108 A. L. R. 1352, *the Court should not shut its eyes to the plain facts and deal with the question in an intellectual vacuum.** The Court should give great weight to the fundamental rule used in construing any written instrument, namely, that it should be construed according to the intention of the contracting parties as gathered from the words of the entire instrument and from the circumstances surrounding the parties at the time when the written agreement was made. . . ."

The petitioner never contended, as the Circuit Court of Appeals seemed to think, that the term "company" generically encompasses the stockholder and, therefore,

*Italics supplied.

United, nor did the petitioner contend that the written agreement was made with United. The contention of the petitioner is that, on the basis of the admitted facts in this case, the Court may properly and should as a matter of law give the agreement the effect which the parties gave to it and that the language of the agreement does not preclude such a result.

In *Alpha Claude Neon Corporation v. Pennsylvania Distilling Co.*, 325 Pa. 140, 188 Atl. 825, the Court said:

> "The rule is here applicable that where the parties have given a certain construction to a contract by their conduct, it is evidence that such a construction was the one intended by them: Colder v. Weaver, 7 Watts 466; Gillespie v. Iseman, 210 Pa. 1; 13 C. J. 546. As this court stated in Fisher v. Ronemus, 267 Pa. 325 (p. 330):
>
> > 'Courts will, if they can, give to the contracts of parties the exact effect which the parties themselves gave to them, and interpret them just as they interpreted them: Gillespie v. Iseman, 210 Pa. 1. When the Court is asked to say what the parties meant or intended by their contract, it is entirely safe to point to their own construction of it, as evidenced by their course of dealing under it: People's Natural Gas Co. v. Braddock Wire Co., 155 Pa. 22, 25; McMillin v. Titus, 222 Pa. 500.' "

In *Brooklyn Life Insurance Co. v. Dutcher*, 95 U. S. 269, the Court said (p. 273):

> "The practical interpretation of an agreement by a party to it is always a consideration of great weight. The construction of a contract is as much a part of it as anything else. There is no surer way to find out what parties meant, than to see what they have done. Self-interest stimulates the mind to activity, and

sharpens its perspicacity. Parties in such cases often claim more, but rarely less, than they are entitled to."

In *Carthage T. P. Mills v. Village of Carthage,* 200 N. Y. 1, the Court stated (p. 14):

> "Practical construction by uniform and unquestioned acts from the outset, especially when continued for a long period of time, is entitled to great, if not controlling weight, for it shows how the parties who made the contract understood it. If they do not know what they meant, who can know? Such a construction is presumed to be right, because it was made by the parties themselves when under the influence of conflicting interests. This is true whether the construction is by contemporaries or their successors, for it is self-interest that makes the construction valuable and safe."

The Circuit Court of Appeals asserts that "the Court will not construe a contract in conflict with the plain and accepted meaning of the language used; or add words to a contract the meaning of which is clear; or hold a covenantor beyond his undertaking", citing *Hagarty v. Wm. Akers, Jr. Co. Inc.,* 342 Pa. 236, 20 A. 2d 317; *B. F. Goodrich Co. v. Wilson,* 337 Pa. 333, 10 A. 2d 422; and *Loeb v. Ferber,* 346 Pa. 348, 30 A. 2d 126. However, in each of those cases, there was a dispute between the parties to the contract as to the meaning whereas here the parties never questioned the meaning as they saw it at the time. Furthermore there is no requirement in this case that the Court hold the petitioner to a covenant beyond its undertaking, because there is no dispute between the petitioner and the bondholder as to the undertaking. The duty is to recognize the actual undertaking and not to preclude the substance in favor of a narrow and literal construction at the instance of a stranger, the tax collector. Many times this Court has said that form is not to be exalted over substance.